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Two agencies for service - life insurance and banking

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Two Agencies for Service—

Life Insurance and Banking

By WALTER W. HEAD
PRESIDENT
THE AMERICAN BANKERS' ASSOCIATION

ADDRESS DELIVERED AT THE
EIGHTEENTH ANNUAL MEETING OF THE
AMERICAN LIFE CONVENTION

DES MOINES, IOWA, OCTOBER EIGHTEENTH
NINETEEN HUNDRED AND TWENTY-THREE

Two Agencies for Service—Life Insurance and Banking.

By

Walter W. Head

Life insurance has two functions. Primarily it guarantees to those who are dependent upon the insured at least a part of the economic value of his life. As a secondary purpose, it constitutes a form of investment.

In its principal aspect, life insurance involves the transfer of the liability of the individual's risk of death to a large number. Life insurance recognizes the fact that the average life is a relatively fixed period, subject to definite calculation, but that each individual life is uncertain, defying exact definition.

As an investment—its secondary function—life insurance retains always its regard for the emergency or uncertain factor. Life insurance constitutes an investment designed not for the ordinary purposes or to meet the expected needs of a life-time, but to form a special reserve to protect the insured against unforseen contingencies.

Life insurance qualifies itself in its investment aspect in two ways. Endowment policies provide for payment of the principal sum at the expiration of a fixed number of years, even though the insured may live beyond the period. In addition, insurance policies have a loan value which permits the insured to borrow against the policy.

This represents the true functions of life insurance. Life insurance is not a system of saving, primarily, although it encourages saving and depends upon saving. Life insurance is the purchase, on the part of one individual, of an interest in the savings of a large number, the individual's profit depending principally upon the altogether uncertain element of the length of his own life. He may make use of the loan value of the insurance policy but when he does, it is to meet an emergency. This is not his primary purpose when he buys insurance.

We must never fail to recognize that the principal purpose of insurance is protection against contingencies not

definitely ascertainable. Life insurance endeavors to safeguard against uncertainties; banking endeavors always to realize upon certainties. Each in some degree at times exercises functions which are particularly in the province of the other, but fundamentally the distinction stands throughout their entire operation.

The fact that the two have fundamentally different purposes does not, however, arouse any antagonism of interest. Rather, the contrary is true. Insurance and banking supplement each other; each supports and strengthens the other.

Dependent on Each Other

With each succeeding year banks and trust companies are increasingly dependent upon life insurance companies and insurance companies are increasingly dependent on banks and trust companies. The bank loans money to its customers. It determines the credit of the prospective borrower by considering his character and ability no less than the collateral which he offers as security. If the borrower dies, his character and ability no longer are assets supporting his note to the bank. Life insurance becomes the safeguard against such a contingency. Its use protects the bank or other creditors against the possibility of the death of the individual in whom they repose trust.

The insurance company, on the other hand, collects vast sums as premiums from the individuals whom it insures. These receipts form the fund out of which it pays the principal sums due the insured or his beneficiaries when the policies mature. Unless the company's condition remains stationary or declines—which, be it said to their credit, is true of few life insurance companies—large funds accumulate as a reserve against the time when the principal sums become due. These funds must be invested and the insurance companies find that banks and trust companies are invaluable aids in securing safe investment opportunities.

These constitute the two outstanding features of the relationship between banking institutions and insurance companies. It is a relationship steadily increasing, both in the amounts involved and the strength of the bond between them.

This year, I am informed, the total amount of new life insurance written by companies doing business in the United States will total over 10 billion dollars. That amount is as

much as the entire amount in force in this country twenty years ago. In 1880, there were less than one million life insurance policies outstanding in the United States, with only one and one-half billion dollars of insurance in force. The amount of insurance in force doubled or more than doubled with each decade and the number of policy-holders increased in even higher ratio. In 1920, including fraternal associations, there were over 65 million policies outstanding, with over 50 billion dollars of insurance in force. The total in force today exceeds 70 billion dollars.

These figures are known to all of you. I recite them merely in order that, as a banker, I may be recorded as paying tribute to the wonderful advancement of life insurance in the last thirty years. It is a tribute to the insurance executives who have conceived the possibilities of life insurance as a great economic and social force, but a tribute even more deserved by the insurance salesmen—the men in the field, who have convinced the individual purchasers that insurance has merit. Opposed by indifference and prejudice, sometimes rebuffed, these men have gone up and down the highways and byways, bringing home to their fellowmen the realization of their duty to their dependents. Upon them is the duty of spreading the word—not only spreading it afar but spreading it accurately, intelligently, with full realization that their service is not measured by commissions but by the exact degree in which they meet the needs of their customers. Providing the protection most needed by each particular individual is the only worth while goal of an insurance salesman; zeal directed to any other end is unworthy of the ideals which insurance inspires.

The banker who does not recognize the importance of this great institution, who does not realize its community of interest with his own business, is indeed blind to one of the great constructive agencies for the advancement of his community and his country.

Both are Trustees

In the case of both banks and insurance companies, the relation to one's customers is in the nature of a sacred trust. No other business has this element in such a degree. In no other business does incompetency or dishonesty bring such widespread disaster. When a bank or insurance company fails, it is not a question merely of loss to stockholders. It is not merely that losses are sustained by ordinary commercial creditors—men accustomed to the risks of business and able

to exercise due precautions in their own behalf. When a bank or insurance company is mismanaged—when its funds are misused—the principal burden falls upon the policy-holders or depositors who, with every confidence, have placed their money in the hands of men upon whom they depend for the future protection of themselves, their business, and their families.

The man or woman who deposits money in a bank expects the interest which is paid on a savings or a time deposit, but the principal service desired and demanded is safety. Likewise the holder of an insurance policy may enjoy the benefits of cash surrender or loan values, but the chief requirement is absolute protection of the business or individuals dependent upon the insured—the certainty that these will benefit in exact fulfillment of the promise made by the insurance company when the policy is purchased.

As executives of banks and life insurance companies recognize and adhere to the absolute pre-eminence of this duty, they are worthy of the trust imposed in them. Disregard of it leads to speculation and misappropriation of the funds held by them as a trust—and then they disgrace themselves in the eyes of God no less than in the eyes of man, for they violate the code of Christian ethics as well as man-made laws. It is to the credit of the men engaged in these activities that few prove recreant to the trust.

This ideal of absolute integrity is an ideal common to banks, trust companies and life insurance companies. More and more, they find other ties, increasing in strength and in the amounts involved, as I have already briefly indicated.

The first test applied to the applicant for a bank loan is the test of Character. Is he honest? Is he competent? Is he diligent? In each case, the possession of life insurance helps to answer the question. The banker knows, from long experience, that the man who is intellectually honest will not fail to provide for the protection of his family; he will have purchased life insurance. The man who cares naught about protecting his family is not apt to care much about protecting his banker. Possession of a life insurance policy does not, of course, constitute a guarantee of honesty but lack of it certainly raises a doubt in the banker's mind as to the borrower's willingness to consider the interests of others who are dependent upon him—either in family affairs or in business. Every man who thinks clearly recognizes the necessity for

reasonable protection of his family in case of his death; therefore possession of adequate life insurance gives some indication of the mental capacity of the prospective borrower. The man who fails to take out sufficient life insurance to protect his dependents—within the limit of his ability—is not properly analyzing his own affairs; he is not "thinking through" his own financial problems. In addition, the man who carries life insurance over a period of years must be accorded credit for persistence and diligence in setting aside the fund necessary to pay the premiums. He gives proof not merely of a sudden inspiration but of a steady insistent desire to set aside a part of his earnings each year for the service of others—his family or his creditors.

Possession of life insurance gives some indication of the borrower's recognition of his obligation to others, some indication of his ability to think clearly, some indication of his diligence.

It is idle to pretend that possession of a life insurance policy is a guarantee of character. It is equally idle, however, to deny that it is an essential factor. The possession of a life insurance policy is a prima facie endorsement of character more potent that the mere listing of one's name on the membership roll of a lodge or a church; it is more effective than a well-tailored suit or a trim haircut. It affords a glimpse of the interior of a man's mental processes, which after all is the important thing.

Protecting Loans

There are other more definite relationships. Protection of business—including loans made by banks—has become a function of life insurance in recent years. This has been accomplished by insurance upon the lives of the men responsible for the policies or operation of the industry affected. It is this class of insurance which has made this year—1923—a banner year in the writing of insurance policies.

As business becomes more intricate and more far-reaching, more dependent upon accumulated inter-relations and affected to a greater extent by happenings throughout the world, the success of a given enterprise depends upon some one individual or group of individuals. Never before has management—the character and ability of the men at the head of an institution—meant so much. A successful executive today must know not merely the production methods and the sales field of his own business; he must know how to deal with labor, how to deal

with government, how to discount the influence of a myriad of factors, including world economics and world politics. The four former essentials of any business—capital, labor, raw materials, market—now have a fifth: MANAGEMENT.

This means that bankers, in financing a business, must pay particular attention to the question of what may happen to their security if the management is altered by death. The question is answered by insuring the life of the managing official or officials in favor of the business or those dependent upon it. The extent to which that is necessary depends upon the nature and size of the business and the quality of its leadership. Realization of its importance has added a new qualification to those required of business executives: The individual should not only be a capable executive, but he should be an acceptable insurance risk.

Capital, as well as management, by means of life insurance, may well afford to protect the business in which it is invested. Inheritance taxes are an increasingly popular form of raising revenue for public purposes. They weigh heavily upon large estates. The payment—in cash, as the government requires—may mean the serious embarrassment of the business. In addition to protection against loss of management, the banker therefore has reason to inquire into the extent to which the prospective borrower has insured the continued and unimpaired supply of capital with which to conduct his business after his own death.

As I have already pointed out, the conduct of a bank is based fundamentally upon the realization of certainties; life insurance is protection against uncertainty. In making a loan, the banker depends upon life insurance to protect him—and the depositors whose money he is loaning—against uncertainties. He makes use of life insurance, in its true function—that of removing uncertainties, in order that he may keep his own business within its proper bounds, dealing in relative certainties.

Loan Values

The loan values of life insurance policies furnish a further source of co-operation with banks in matters of finance. Investment of capital, either through stock ownership or through loans, constitutes the use of funds accumulated from the profits and the savings of the past. In time of emergency these may not be sufficient. Then it is that life insurance may be used to furnish emergency capital—not by using the accumulation of the past but by drawing upon the reserves set aside for the future.

In periods of economic depression like that of 1920, 1921 and 1922, many men were saved from certain financial ruin by the loan values of life insurance policies. Insurance loans were, to them, the "last straw" which prevented their sinking.

Permit me, however, to sound a warning note against the too ready use of the surrender and loan values of life insurance policies. It may be said that, as a banker, I am interested in the release of life insurance reserves for purposes of active commerce and industry. But, as a citizen vitally interested in the underlying stability of our economic and social problems, I am most earnestly desirous that these reserves be maintained for the purpose for which they are created—the protection of the family or business of the insured in case of his death—that they be used only for other purposes as a last resort. Life insurance has a social as well as an economic and financial aspect. With some exceptions, it is safe to assume that no man carries more insurance than his family or his business would require in case of his death. His purpose, when he buys insurance, is to assure that protection. When he borrows upon his policy, he reduces the protection. There are times when this action is justified, times when an insurance loan may save a much larger investment. But it is a serious matter, to be undertaken only in grave emergency and for a purpose unquestionably justified. There is an essential difference between the making of profits in every-day business and the creation of a fund for future protection. The man who disregards that distinction—without complete and thorough justification—is not serving well either himself or his community.

Co-operation in Investments

Insurance aids banking by safeguarding business. On the other hand banks and trust companies are of service to the insurance companies in connection with the accumulated insurance reserves, which now reach tremendous totals. The investment of these funds has been a problem of increasing importance and intricacy. Banks and trust companies, equipped in organization and by years of experience, have been and are able to give substantial assistance in its solution.

Life insurance reserves have grown to such tremendous amounts in recent years that no one field of investment can afford an adequate outlet, consistent with requirements of

safety and continuous investment opportunity. Insurance companies for many years invested heavily in municipal bonds and in railroad securities of the higher grades. As their resources grew, they turned increasing attention to real estate mortgages and today they are second only to the farm land banks in their importance as mortgage investors.

The great companies which have their headquarters in New York City were and are able to purchase corporate bonds upon their own judgment, although frequently they seek advice of banking and investment houses. The companies established in other states which, in the aggregate, comprise a great part of the total of life insurance activity, have not enjoyed such close touch with the investment market and, consequently, have generally found it to their advantage to deal with investment banks and trust companies. Banks and trust companies which have been of such service are proud of the opportunity that has been afforded them to co-operate with the great institution of life insurance.

In the real estate mortgage field, the investment banker has been an essential ally of the insurance company. It is possible but it is not economical or practicable for an insurance company to operate its own mortgage investment department, to make its own loans direct to the farmers, to make its own appraisal of the land to be mortgaged. The investment bankers deal in such securities not only for one insurance company but for a great clientele. The investment banker in each particular territory is able, economically, to maintain a sufficient force of capable inspectors in the field. They are in touch with local conditions and are able to arrange loans more advantageously than would otherwise be the case. Furthermore, as a group, they cover a far wider field than that reached by a single insurance company and do it more intensively. The insurance company can draw upon their combined experience and judgment. It is the advantage of what manufacturers term "volume production."

This mortgage investment relationship provides mutual benefits. The insurance companies need the investment bankers as agents to loan money. The banks are able to serve their communities all the better because they have access to the great store of insurance funds. The combination has made it possible for the whole country to benefit from these great investment resources instead of having the benefit restricted in communities closely in touch with the home offices of insurance companies. One result of this relationship has

been that the average banker looks with greater favor upon insurance. Instead of seeing a steady flow of money out of his community, in the form of insurance premiums, he now sees also the money which comes back to the community in the form of mortgage loans and the payment of principal sums upon the death of the insured.

Insurance Trusts

Another still more recent development is the use of the trust companies as an agency for carrying out the wishes of insurance policy holders. Frequently, insurance funds are placed under the control of trust companies who administer them for the benefit of the beneficiaries, in accordance with the direction of the insured. In some cases, this has included the establishment of "community trusts," where large amounts have been set aside for public or charitable purposes, the detail of administration being left to the judgment of the trust company. Trust companies also frequently become trustees for securities or other property, under instructions which provide that they use the income to pay insurance premiums. This plan has certain advantages in reducing income taxes and also makes certain that there will always be a fund sufficient to keep the insurance in force.

In still another respect, there has been an increasing mutuality of interest between bankers and insurance companies. The bankers are concerned always with the conduct of great corporate enterprises, the prosperity of which affects materially the general business of the country. Insurance companies have become a very great factor in the financing of many of these concerns. As a unit they have been the largest single purchasers of high-grade bonds. The sound conservatism of their investment policy has been so widely esteemed that purchase by an insurance company has constituted a stamp of quality. Bankers and insurance companies therefore have a mutual interest in the conduct of these enterprises along lines which will insure their continued successful operation.

Opportunity for Service

The control of these vast investment funds gives the insurance companies a great opportunity for public service. Fundamentally, they hold the funds in trust for millions of individuals and their only interest, aside from the prime interest of safe investment, should be the interest of the policy holders which means—in view of the number of policies

written—the interest of the great body of citizens who make up the nation. Take the case of the railroads as an example. The insurance companies hold hundreds of millions of dollars of railroad bonds. Insofar as they may influence the railroad policy or be concerned in it, they have no interest at stake except that the roads be operated and financed in such a manner as to make their investment safe, and to satisfactorily serve the public. They can not—without being recreant to their trust—be parties to any manipulation for selfish purpose. Their duty is to represent the public at large and the source of their funds makes them independent of any other influence.

In the determination of investments—in deciding the extent to which they will invest money in certain fields—the insurance company executives have the power to exercise a great influence upon the development or prosperity of certain sections of the country or certain lines of commerce and industry. It is a great opportunity and no other group of men controlling such large accumulations of capital, are equally free to act without regard to selfish interest but with sole regard to the interest of those for whom they are trustees.

The insurance company executive, like the banker, has an opportunity to win for himself a high place of leadership by reason of the service which he renders. Won by service, such leadership possesses far greater influence and is far more permanent than leadership achieved by any other means. Men may follow a leader under compulsion, but the service they give him is not to be compared with that which they render a leader whom they follow by their own choice because he, in turn, serves them.

This is a time when intelligent, unselfish leadership is the need of our country. We are drifting—drifting too far from established standards and with too little intelligent direction. With natural resources under our control, and subject to our use to a greater extent than ever before, with greater accumulated resources of capital than ever before, still we find a world sadly disorganized—politically, economically, socially. We have passed through a period of excessive speculation, a period when man's ambition seemed to be to seize everything for himself, regardless of others. The climax was reached in the World War, when all fell victims to the insatiate desire for a larger share of the world's wealth—at any cost. We have passed through that period, I verily believe. But we have not yet placed our feet on solid ground.

We are offered many remedies. Some are panaceas. Some are plans for genuinely constructive effort. Still—uncertain, without charted course—we drift.

Through all this period, the steady growth of life insurance has been a source of constant encouragement, like a beacon light at night on a rocky coast. The people of our country have purchased life insurance policies in number without precedent and for tremendous amounts. This has constituted the creation of great reserves of capital beyond touch of the speculative fever, capital which forms a part of the solid foundation of basic investment—but that is not all. The possession of this tremendous amount of insurance indicates that forces are at work in the minds of Americans other than a mere desire for quick and large profits. The speculative fever has been carried to excess, but it has not swept away everything before it. Despite it, fighting against it, has been the sober realization that a part of today's income should be set aside for future need. Beset on every side by the desire for quick and easy wealth, the ideal of thrift may have been sadly battered, but it has not been conquered. The American people may have been lured to follow false gods of finance, but they have not failed at least to cast an anchor to windward.

It is under these conditions that there arises the need for leadership, intelligent, conservative, enlightened, self-sacrificing leadership. The call goes to every American citizen, regardless of his position in life or the nature of his task. It should appeal with particular force to the banker and the insurance executive because of their greater appreciation of the need, because of their special opportunity, because of the inspiration which comes from their knowledge of the vast importance of their particular task.

The banker and insurance executive can and should aid each other—and in the service they render jointly, they are a potent and valuable factor in the advancement of their country. Together they can exercise a great influence for the restoration of sound, substantial principles—of government, of business, of individual conduct. Together they can labor most effectively for constructive progress, for repudiation of false principles, for adherence to ideals that have been tried and proven worthy—for thrift, for honest dealing between men, for unselfish consideration of others.

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